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No. 91-886

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In the Supreme Court of the United States

OCTOBER TERM, 1991

BOB REVES, ET AL., PETITIONERS

v.

ERNST & YOUNG

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether the phrase "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs through a pattern of racketeering activity" in the RICO statute requires proof that the defendant exercised control over the management or operation of the enterprise.

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INTEREST OF THE UNITED STATES

The Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1961 *et seq.*, imposes criminal and civil liability for specified forms of racketeering activity. This case presents an issue that arises in both criminal and civil RICO actions: Whether the phrase "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs through a pattern of racketeering activity" in 18 U.S.C. 1962(c) requires proof that the defendant exercised control over the management or operation of the enterprise. The United States prosecutes a wide variety of criminal activity under the RICO statute and on occasion institutes civil actions under the statute. In our view, the court of appeals' holding that the defendant must have participated in operating or managing the enterprise in order to be held liable under Section 1962(c) is unfounded and

threatens to impede the government's enforcement of the RICO statute. Accordingly, the United States has a significant interest in the Court's resolution of this case.

STATUTE INVOLVED

The pertinent provision of the RICO statute, 18 U.S.C 1962, is set forth in an appendix to this brief.

STATEMENT

1. Petitioners are a class of shareholders and purchasers of demand notes in the Farmer's Cooperative of Arkansas and Oklahoma, Inc. (Co-op). The Co-op's Board of Directors was elected by its membership, which consisted of local farmers. Day-to-day management of the Co-op was delegated to a general manager. In 1952, the Board appointed Jack White as general manager. Pet. App. A6. In 1979, White and one other individual formed an independent venture to construct a gasohol plant. White borrowed extensively from the Co-op to finance the plant, eventually running up a debt to the Co-op of $4 million. Although the plant was completed in April 1980, it soon experienced serious financial difficulties. *Id.* at A8-A9.

In September 1980, White was indicted for federal tax fraud. Pet. App. A9. At White's criminal tax trial, Harry Erwin, an accountant, testified on White's behalf. Erwin was the managing partner of Russell Brown and Company, a local accounting firm. In January 1981, White was convicted. *Id.* at A12-A13. Soon afterward, the Co-op retained Erwin's firm to perform the Co-op's 1981 financial audit. *Id.* at A13-A14. Erwin's firm was acquired by Arthur Young and Company, which later became respondent Ernst & Young. *Id.* at A13 n.5.

After White's indictment, the Co-op Board of Directors, at White's request, voted to purchase the gasohol plant. Pet. App. A9-A10. Upon starting the 1981 audit process, respondent immediately learned that the Co-op's financial reporting of the gasohol plant posed considerable problems.

The 1980 financial statements for the Co-op had been prepared by its former accountant, who stood convicted of tax fraud along with White. Realizing that those statements were not reliable, respondent made its own effort to determine the value of the Co-op's interest in the gasohol plant.[1] As a result of that effort, respondent developed a value for the plant of $4 million. That figure, although purportedly derived by respondent independently, matched exactly the value developed by the Co-op's former accountant, even though that accountant had based his valuation on fabricated construction costs and expenses. *Id.* at A16. Respondent's value also significantly overstated the plant's actual value, which was at most $1.5 million. If the plant had been valued accurately, the Co-op would have been insolvent. *Id.* at A14-A20.

In April 1982, respondent presented its audit report to the Co-op's Board. Pet. App. A20-A21. The report indicated that respondent had "some doubt" that the Co-op would recover its investment in the gasohol plant and was "unable to satisfy" itself about the proper carrying value of the plant. *Id.* at A21. The attached financial statements showed the gasohol plant as representing more than a quarter of the Co-op's assets. *Ibid.* Respondent did not advise the Board about the method used to determine the value of the gasohol plant, nor did it ever ask the Co-op's Board or management for projections on whether the plant would succeed. *Id.* at A23.

On May 27, 1982, the Co-op held its annual meeting. The Co-op prepared condensed financial statements from respondent's submissions, and distributed the condensed statements to members. The condensed statements listed the gasohol plant as a $4.5 million asset, but did not disclose that the plant had experienced losses of $1.2 million.

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[1] Respondent did not seek or obtain a representation letter from management stating that the Co-op's financial records were accurate and prepared in accordance with generally accepted accounting principles. Pet. App. A30 n.11.

Nor did the condensed statements explain that respondent had questioned whether the cost of the plant was recoverable. Pet. App. A23-A24.[2] Representatives of respondent attended the meeting and made a five-minute presentation discussing the condensed financial statements and the Co-op's financial picture. *Id.* at A25-A26. In response to members' questions, respondent disclosed that the plant had lost $1.2 million. Respondent failed, however, to disclose the way in which it had valued the plant. Respondent also failed to disclose that it could not satisfy itself regarding the carrying value of the plant, and that a write-down of the plant would render the Co-op insolvent. *Id.* at A26-A27.

Respondent was again retained for the 1982 audit. It prepared an audit report substantially like the prior year's report.[3] Pet. App. A27-A31. The Co-op then undertook to draft condensed financial statements for its members. Respondent advised the Co-op that, without respondent's explanatory notes, the condensed statements would be misleading. The Co-op, however, distributed the condensed financial statements without respondent's notes and indicated that the statements were derived from respondent's annual audit. Respondent was aware that those statements were deficient, but it took no action. *Id.* at A32.

At the Co-op's annual meeting, respondent gave a three-minute financial report to members based on the condensed financial statements. It did not inform members that the statements were misleading. Nor did respondent disclose that it could not satisfy itself about the value of the gasohol plant and that a write-down of the plant would make the Co-op insolvent. Pet. App. A33-A34.

Within a year, the Co-op declared bankruptcy. According to its bankruptcy filings, one of the Co-op's major problems was the financial condition of the gasohol plant. Pet. App. A35-A36. As a result of the bankruptcy, the Co-op's demand notes became unredeemable. *Id.* at A36.

2. The trustee appointed by the bankruptcy court filed suit against respondent and others on behalf of the Co-op and certain demand noteholders. Pet. App. A36-A37. The complaint alleged, *inter alia*, that respondent had violated Section 1962(c) of the RICO statute, 18 U.S.C. 1962(c), by associating with an "enterprise"—the Co-op—and conducting or participating in the conduct of the Co-op's affairs through a pattern of mail, wire, and securities fraud violations.[4] As relief, the complaint sought treble damages under 18 U.S.C. 1964(c). Complaint ¶¶ 154-163.

In 1985, the district court certified a class of purchasers of demand notes during the relevant period. The court denied respondent's motion to dismiss the RICO count, but granted its motion for summary judgment on that claim. Pet. App. A36-A37, A58-A60. The court held that respondent could not be shown to satisfy RICO's requirement that a defendant "conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs." 18 U.S.C. 1962(c). In so holding, the district court relied on the statement in *Bennett* v. *Berg*, 710 F.2d 1361, 1364 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008

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[2] Respondent later concluded that the condensed financial statements were "misleading." Pet. App. A28.

[3] Respondent drafted representation letters for management's signature that stated that the Co-op's financial statements were accurate and prepared in accordance with generally accepted accounting principles. The Co-op's new general manager signed such a letter, but its chief financial officer refused to do so. That is ordinarily grounds for an auditor to disclaim an opinion or to qualify its audit report, but respondent did neither. Pet. App. A29-A30.

[4] The RICO statute defines an "enterprise" as including "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. 1961(4). "Racketeering activity" is defined to include, *inter alia*, "any act which is indictable" under 18 U.S.C. 1341 or 1343, the mail fraud and wire fraud statutes, or "any offense involving * * * fraud in the sale of securities." 18 U.S.C. 1961(1)(B) and (D).

(1983), that the "conduct or participate" element "ordinarily will require some participation in the operation or management of the enterprise itself."[5] Pet. App. A58-A60. According to the district court, respondent's auditing activities did not reflect the requisite "degree of management" because they involved only the review of completed transactions and the certification of the Co-op's records as fairly portraying its financial status. *Id.* at A60.[6]

3. The court of appeals affirmed the entry of summary judgment in respondent's favor on the RICO claim. Pet. App. A44-A48. Applying the standard set forth in *Bennett* v. *Berg*, *supra*, the court of appeals stated that respondent's "involvement with the Co-op was limited to the audits, meetings with the Board of Directors to explain the audits, and presentations at the annual meetings." Pet. App. A46. Although noting that "[i]n the course of this involvement it is clear that [respondent] committed a number of reprehensible acts," the court of appeals concluded that "these acts in no way rise to the

[5] In *Bennett*, residents of a retirement community filed a RICO claim against the owners, financiers, lawyers, and accountants for the community, alleging that they had conducted the financial affairs of the community through fraudulent activities that caused losses to the plaintiffs. The court of appeals held that the complaint stated a claim under RICO, but, in remanding for further proceedings, expressed concern that the plaintiffs may not have adequately pleaded "the requisite degree of participation in or conduct of the affairs of the community" on the part of the outside financiers, lawyers, and accountants. 710 F.2d at 1364.

[6] The case went to trial on other claims, and the jury found, *inter alia*, that respondent had committed securities fraud in violation of federal and state law. See Pet. App. A4. The district court entered judgment against respondent in the amount of $6,121,652, subject to certain credits from settlements. *Id.* at A42. The court of appeals initially reversed, holding that the demand notes were not securities under the federal securities laws. *Id.* at A43. This Court reversed that holding. *Reves* v. *Ernst & Young*, 494 U.S. 56 (1990). On remand, the court of appeals affirmed the judgments on the securities fraud claims. *Arthur Young & Co.* v. *Reves*, 937 F.2d 1310, 1333 (8th Cir. 1991).

level of participation in the management or operation of the Co-op." *Ibid.*

SUMMARY OF ARGUMENT

A. RICO makes it unlawful for a person associated with an enterprise "to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity." 18 U.S.C. 1962(c). That provision does not require proof that the defendant managed or operated an enterprise, or participated in doing so, in order for the defendant to be held liable. A person who "conducts" an activity, in the ordinary sense of the word, may be either a person who leads the activity or one who participates in carrying it forward. That meaning accords with Congress's express inclusion, in the class of persons subject to liability, of those who "participate" in conducting the enterprise's affairs "directly or indirectly."

The legislative history, to the extent it is relevant, offers no support for the court of appeals' "operation or management" test. Nor can such a test be reconciled with RICO's purposes. One of the principal objectives of the RICO statute is to prevent the infiltration of legitimate businesses by criminal actors. The concept of infiltration applies to outsiders who usurp or corrupt the functions of an enterprise, even when they do not assume managerial or operational control of the entity. Accordingly, a "conduct or participate" test that limits RICO's reach to high-level actors who gain control of an enterprise would defeat one of the central purposes of the statute.

B. RICO's "conduct or participate" element requires that the defendant take part in carrying out the activities of the enterprise by means of a pattern of predicate crimes. The requisite connection may be established in various ways, in keeping with the diversity of relationships that defendants can have with the enter-

prise. In general, the "conduct or participate" requirement is satisfied whenever the defendant (a) engages in racketeering activity through the enterprise that furthers the enterprise's objectives; (b) uses the enterprise's resources or his association with the enterprise to facilitate his crimes; or (c) engages in criminal activity designed to corrupt the enterprise's actions.

C. The courts below applied an incorrect legal analysis in granting summary judgment to respondent. Whether respondent sufficiently participated in the conduct of the Co-op's affairs does not turn on whether it operated or managed the Co-op; it turns instead on the nature of respondent's role in preparing and explaining the Co-op's financial information through the alleged pattern of false and misleading statements. The case should be remanded to the court of appeals for further consideration of that issue.

ARGUMENT

THE RICO STATUTE DOES NOT REQUIRE THAT A DEFENDANT PARTICIPATE IN THE MANAGEMENT OR OPERATION OF AN ENTERPRISE IN ORDER TO BE HELD LIABLE UNDER 18 U.S.C. 1962(c)

A. The Language And Purposes Of RICO Are Inconsistent With A Requirement That The Defendant Manage Or Operate The Enterprise

On its face, RICO contains no requirement that a defendant manage or operate an enterprise, or participate in those functions, in order to be liable under 18 U.S.C. 1962(c). The statute requires that the defendant have a connection with the enterprise in three respects: first, the defendant must be "employed by or associated with" the enterprise; second, the defendant must "conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs"; and third, the defendant's involvement in the enterprise's affairs must be "through a pattern of racketeering activity." Nothing in any of those provisions suggests that the defendant must manage, lead, control, or operate the enterprise in order to be subject to liability under RICO.[7]

1. *Statutory language.* The word "conduct" is used as both a verb and a noun in Section 1962(c); a person is liable if he "conduct[s] * * * [the] enterprise's affairs" through the proscribed pattern, or if he "participate[s] * * * in the conduct of such enterprise's affairs." It is appropriate to give the word "conduct" a similar construction in those two phrases, see *Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986),

[7] A majority of the courts of appeals do not apply a management or operation test, but examine the defendant's connection to the enterprise under a standard more in keeping with the breadth of the statutory language. See *United States* v. *Scotto*, 641 F.2d 47, 54-55 (2d Cir. 1980) (the "conduct" element is satisfied where "(1) one is enabled to commit the predicate offenses solely by virtue of his position in the enterprise or involvement in or control over the affairs of the enterprise, or (2) the predicate offenses are related to the activities of that enterprise"), cert. denied, 452 U.S. 961 (1981); *United States* v. *Provenzano*, 688 F.2d 194, 200 (3d Cir.) (same), cert. denied, 459 U.S. 1071 (1982); *United States* v. *Yarbrough*, 852 F.2d 1522, 1544 (9th Cir.) (same), cert. denied, 488 U.S. 866 (1988); *United States* v. *Cauble*, 706 F.2d 1322, 1333 (5th Cir. 1983) (the "conduct" element entails a showing, where the enterprise is a legitimate business, that "(1) the defendant has in fact committed the racketeering acts as alleged; (2) the defendant's position in the enterprise facilitated his commission of the racketeering acts, and (3) the predicate acts had some effect on the lawful enterprise"), cert. denied, 465 U.S. 1005 (1985); *United States* v. *Pieper*, 854 F.2d 1020, 1026 (7th Cir. 1988) (same). See also *Bank of America* v. *Touche Ross & Co.*, 782 F.2d 966, 970 (11th Cir. 1986) ("'conduct' * * * simply means the performance of activities necessary or helpful to the operation of the enterprise"). In general, these cases integrate into a single inquiry the issue whether the defendant "conducted or participated" in the conduct of the enterprise's affairs, and whether he did so "through" a pattern of racketeering activity. That approach is consistent with RICO's focus on the relationship between criminal conduct and the enterprise. The nature and method of the defendant's crimes must be examined to determine whether he has "conducted or participated" in the conduct of the enterprise's affairs "through" the pattern of predicate crimes.

and to determine the meaning of the statutory language in light of its context and the structure of the statute as a whole, see *King* v. *St. Vincent's Hospital*, 112 S. Ct. 570, 574 (1991).

a. The court of appeals read the term "conduct" restrictively, to apply only to a person who participates in the "operation or management" of an enterprise. See *Bennett* v. *Berg*, 710 F.2d at 1364, citing *United States* v. *Mandel*, 591 F.2d 1347, 1375 (4th Cir. 1979) ("the 'conduct or participate' language in § 1962(c) require[s] some involvement in the management or operation of the business"), vacated on other grounds, 602 F.2d 653, cert. denied, 445 U.S. 961 (1980).[8] That construction, however, is contrary to the "ordinary meaning" of the term "conduct." See *Russello* v. *United States*, 464 U.S. 16, 21 (1983). It is generally recognized that persons who take part in carrying out the activities of an enterprise "conduct" the enterprise's affairs, even if they do not lead or direct its activities. The definition of the verb "conduct" includes the meaning, "To direct, manage, carry on (a transaction, process, business, institution, legal case, etc.)." 3 *Oxford English Dictionary* 691 (2d ed. 1989). That definition, however, pointedly adds: "The notion of direction or leadership is often obscured or lost; e.g. an

[8] *Mandel*, which was the sole authority cited by the court of appeals in *Bennett* v. *Berg*, gave scant attention to the level and quality of the relationship that the defendant's crimes must have to the enterprise. *Mandel* held only that the transfer of a legitimate business to the defendant as a payoff for fraudulent activity did not amount to conducting or participating in the conduct of *that* business through the predicate crimes. 591 F.2d at 1376. A later decision of the Fourth Circuit applied RICO to an outsider who committed criminal acts through use of the enterprise's resources, without managing, operating, or controlling it. See *United States* v. *Webster*, 639 F.2d 174 (1981), modified, 669 F.2d 185, 187 (upholding a RICO conviction where the defendants' participation in the conduct of the enterprise's affairs consisted of using the telephone, facilities, and personnel of an entertainment club as a base for carrying out narcotics transactions), cert. denied, 456 U.S. 935 (1982).

investigation is *conducted* by all those who take part in it." *Ibid.* To the same effect is *Webster's Dictionary of Synonyms* 184 (1942), which states that "[c]onduct may imply the act of an agent who is both the leader and the person responsible for the acts and achievements of a group having a common end or goal * * *, but often the idea of leadership is lost or obscured, and the stress is placed on a carrying on by all or by many of the participants."

There is no indication that Congress intended a narrower meaning in RICO. As this Court has noted, "the pattern of the RICO statute" is to "utiliz[e] terms and concepts of breadth." *Russello*, 464 U.S. at 21 (citing as an example the term "participate" in Section 1962(c)); see *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 497-498 (1985) ("RICO is to be read broadly" in accordance with "Congress' self-consciously expansive language and overall approach"). To substitute for the statutory term "conduct" a formulation that looks to "management," "significant control," or "running the show," *Yellow Bus Lines, Inc.* v. *Drivers Local Union 639*, 913 F.2d 948, 954 (D.C. Cir. 1990) (en banc), cert. denied, 111 S. Ct. 2839 (1991), reads a limitation into RICO that Congress did not enact.[9]

This Court has previously rejected judicially fashioned tests that would impose severe restrictions on RICO's

[9] The D.C. Circuit is the only court of appeals since *Bennett* v. *Berg*, *supra*, to have embraced a "management or operation" standard, and it did so in a fashion that appears to be even more restrictive than the Eighth Circuit's test. See *Yellow Bus*, 913 F.2d at 954 (Section 1962(c) requires "guidance, management, direction or other exercise of control over the course of the enterprise's activities."). *Yellow Bus* asserted that "'[c]onduct' is synonymous with 'management' or 'direction.'" *Ibid.*, quoting *Webster's Third New International Dictionary* 473 (1961). The quoted definition, however, is incomplete. The dictionary cited by the court of appeals defines "conduct" as "the act, manner, or process of carrying out (as a task) or carrying forward (as a business, government, or war); management; direction." *Ibid.* As we have noted, other dictionaries suggest that all participants who carry out an enterprise's business "conduct" its affairs.

broad scope. See *H.J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229, 241 (1989) (rejecting "multiple scheme" limitation on RICO's "pattern" requirement because of lack of support in the statutory text or legislative materials); *Sedima*, 473 U.S. at 496 (rejecting racketeering injury requirement); *United States* v. *Turkette*, 452 U.S. 576, 583 (1981) (rejecting requirement that enterprise be a legitimate business). The "operation or management" limitation adopted by the court of appeals is equally unfounded.[10]

b. An "operation or management" approach also overlooks the statutory context of the specific prohibition. Section 1962(c) applies to any person who is "employed by *or* associated with" the enterprise, 18 U.S.C. 1962(c) (emphasis added)—a relationship that plainly includes lower-rung participants in organized criminal activity, as well as "outsiders" who have no official position within the enterprise. In addition, Section 1962(c) covers not only those who "conduct" the enterprise's affairs, but also those who "participate" in the conduct of those affairs, "directly or indirectly." That language is unmistakably broad. If Congress had intended to reach only those who had attained some "significant control" over the management or operation of an enterprise, see *Yellow Bus*, 913 F.2d at 954, it would not have employed terms that include indirect participants as well as those directly responsible for conducting the affairs of the enterprise.

Congress is quite familiar with language that restricts the reach of an offense to the "principal administrator"

[10] See *United States* v. *Horak*, 833 F.2d 1235, 1239 (7th Cir. 1987) (" 'conduct' in section 1962(c) does not mean 'control' or 'manage' "); *United States* v. *Scotto*, 641 F.2d at 54 (rejecting the claim that "the jury was required to find that the predicate acts 'concerned or related to the operation or management of the enterprise' "); *Bank of America* v. *Touche Ross & Co.*, 782 F.2d at 970 ("It is not necessary that a RICO defendant participate in the management or operation of the enterprise.").

or "leader" of an enterprise. The Continuing Criminal Enterprise statute is written in precisely those terms. See 21 U.S.C. 848(b)(1) (prescribing penalties for "[a]ny person who engages in a continuing criminal enterprise * * * if—such person is the principal administrator, organizer, or leader of the enterprise or is one of several such principal administrators, organizers, or leaders").[11] RICO, however, takes a different approach. As this Court has noted, "Congress drafted RICO broadly enough to encompass a wide range of criminal activity, taking many different forms, and likely to attract a broad array of perpetrators operating in many different ways." *H.J. Inc.*, 492 U.S. at 248-249.

2. *Legislative history.* To the extent that RICO's legislative history is relevant here, it provides no support for a narrowing "operation or management" gloss on Section 1962(c). For the most part, as is often the case, the legislative descriptions of Section 1962(c) merely track the statutory language. For example, the House Report states that "[s]ubsection (c) prohibits the conduct of the enterprise through the prohibited pattern of activity or collection of debt." H.R. Rep. No. 1549, 91st Cong., 2d Sess. 57 (1970). The Senate Report, in its section-by-section analysis of the bill, provides a similar statement while making clear that no minimal "percentage" of the enterprise's activities need be affected by racketeering to trigger the application of Section 1962(c). S. Rep. No. 617, 91st Cong., 1st Sess. 159 (1969).[12] That explanation

[11] Congress also made it a racketeering act under RICO, see 18 U.S.C. 1961(1)(B), when a person either "conducts" *or* "manages, supervises, [or] "directs" an illegal gambling business in violation of 18 U.S.C. 1955(a) ("Whoever conducts, finances, manages, supervises, directs, or owns all or part of an illegal gambling business shall be fined not more than $20,000 or imprisoned not more than five years, or both.").

[12] The Report notes that, unlike Section 1962(a), which provides an exception to the prohibition against investing funds derived from racketeering activity in an enterprise "where there is no re-

provides no support for the view that Congress envisioned that the defendant must manage or operate the enterprise before being exposed to RICO liability under Section 1962(c).

In *Yellow Bus*, 913 F.2d at 954, the court cited language in the Senate Report stating that RICO's goal is to attack "corruption in the acquisition or operation of business." S. Rep. No. 617, *supra*, at 81. That shorthand description, however, did not describe the reach of Section 1962(c); it appears in a passage of the Senate Report explaining the need for civil remedies analogous to divestiture in the antitrust field. Moreover, the description seems more pertinent to Section 1962(a), which prohibits a person from using or investing the proceeds of a pattern of racketeering activity "in acquisition of any interest in, or the establishment or operation of, any enterprise." 18 U.S.C. 1962(a). The fact that Congress explicitly prohibited the "operation" of the enterprise with racketeering proceeds in Section 1962(a) suggests that no "operation" requirement should be imported into Section 1962(c). Nor should a "control" requirement be added to Section 1962(c); Congress addressed "control" issues in Section 1962(b). See 18 U.S.C. 1962(b) (prohibiting, *inter alia*, the acquisition of "control" over an enterprise through a pattern of racketeering activity)[13]

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sulting control in law or in fact to the investor," Section 1962(c) applies to any "conduct of the enterprise through the prohibited pattern"; there is no quantitative "limitation on the prohibition." S. Rep. No. 617, *supra*, at 159.

[13] A few general comments in the course of the floor debate addressed Section 1962(c) without purporting to analyze the "conduct" requirement. See, *e.g.*, 116 Cong. Rec. 602 (1970) (remarks of Sen. Hruska) (RICO "is designed to remove the influence of organized crime from legitimate business by attacking its property interests and by removing its members from control of legitimate businesses which have been acquired or operated by unlawful racketeering methods. Stated simply, this legislation * * * would * * * prohibit any person employed by or associated with such an enterprise from conducting the enterprise's affairs by a pattern of racketeering activity."). In passing, some legislators used the word "operate" in discussing the prohibition reflected in Section 1962(c) without elaborating on that concept. *Id.* at 607 (remarks of Sen. Byrd); *id.* at 18,941 (remarks of Sen. McClellan). Only one reference in the House debate mentioned the idea of management, see *id.* at 35,196 (remarks of Rep. Celler) ("The conduct of the affairs of a business by a person acting in a managerial capacity, through racketeering activity is also proscribed."). That reference did not indicate that proof of management would be required to establish a violation, however. In any event, in light of the language Congress enacted, that solitary reference could not justify the interpretation advanced by the court of appeals. *Cf. Holmes* v. *Securities Investor Protection Corp.*, No. 90-727 (Mar. 24, 1992), slip op. 9 n.15.

3. *RICO's purposes.* Finally, the "operation or management" approach directly conflicts with RICO's major purpose: to attack the "infiltration of organized crime and racketeering into legitimate organizations." S. Rep. No. 617, *supra*, at 76. The "infiltration" of an enterprise can take place gradually and inflict serious injury long before it reaches the corporate boardroom. The concept of infiltration suggests actions by outsiders who usurp or corrupt the functions of an enterprise, without necessarily assuming formal management or control over its day-to-day operations. To wait until the enterprise has been captured at its upper echelons would thwart the purpose of the statute to arrest and prevent infiltration from its inception.

The "management or operation" test would have little significance if it did not serve to limit RICO's application to relatively high-level criminal actors.[14] Yet such a result

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[14] In fact, the court of appeals' test is highly ambiguous. The "management" prong appears to require more than the power to employ the enterprise as the vehicle for the predicate crimes, but the court has not said what more is required. The "operation" prong is even less clearly defined. For example, it is not clear whether "operation" of the enterprise includes the direction of routine business affairs. Even assuming that workable answers could be found, courts would have to provide them by interpreting words that are not in the statute. It makes little sense to develop a complex jurisprudence around a "test" that has no anchor in the relevant statutory provision.

would prevent RICO from reaching "[b]oth the captains and the lately enlisted foot soldiers in the enterprise." *Town of Kearney* v. *Hudson Meadows Urban Renewal Corp.*, 829 F.2d 1263, 1269 (3d Cir. 1987); *United States* v. *Elliott*, 571 F.2d 880, 903 (5th Cir.) ("the RICO net is woven tightly to trap even the smallest fish, those peripherally involved with the enterprise"), cert. denied, 439 U.S. 953 (1978).[15] RICO was intended to permit the dismantling of organized crime enterprises from top to bottom. See 116 Cong. Rec. 18,939 (1970) (remarks of Sen. McClellan). A test that would frustrate that objective is inconsistent with RICO's remedial aims.

B. The "Conduct Or Participate" Element Requires That The Defendant Take Part In Carrying Out The Affairs Of The Enterprise Through A Pattern Of Unlawful Acts

RICO's "conduct or participate" element requires a showing with respect to *how* the defendant used the enterprise in the course of his criminal activities: the defendant must be shown to have taken part in carrying out the activities of the enterprise by means of the prohibited predicate crimes. That requirement can be satisfied in a variety of ways, which are illuminated by the types of cases in which RICO has been traditionally applied.

1. *The general concept underlying the "conduct or participate" requirement.* RICO's "conduct or participate" element requires more than that the defendant be "employed by or associated with" the enterprise and engaged

[15] See also *United States* v. *DePeri*, 778 F.2d 963, 983 (3d Cir. 1985) (RICO applies to a "courier" or "go-fer"; the statute "draws no distinction between the foot soldier and the general"), cert. denied, 475 U.S. 1110 (1986); *United States* v. *Carlock*, 806 F.2d 535, 546 (5th Cir. 1986) (RICO applies to union member who received bribes), cert. denied, 480 U.S. 949 (1987); *United States* v. *Starnes*, 644 F.2d 673, 679 (7th Cir.) (RICO applies to a person recruited by the company president to burn a company building), cert. denied, 454 U.S. 826 (1981).

in crimes.[16] It also requires more than a coincidental or tangential connection between the enterprise, the defendant, and the pattern of racketeering activity. See *Averbach* v. *Rival Mfg. Co.*, 809 F.2d 1016, 1018 (3d Cir.) (filing a false interrogatory response was not participating in the conduct of the court's affairs), cert. denied, 482 U.S. 915 (1987); *United States* v. *Nerone*, 563 F.2d 836, 851-852 (7th Cir. 1977) (carrying out illegal gambling in a trailer park was not conducting the affairs of the corporation that operated the park), cert. denied, 435 U.S. 951 (1978); *United States* v. *Dennis*, 458 F. Supp. 197, 199 (E.D. Mo. 1978) (collecting unlawful debts on the premises of the employer did not constitute participating in the conduct of the employer's affairs through illegal debt collection), aff'd on other grounds, 625 F.2d 782 (8th Cir. 1980).

The requisite relationship, however, may be "direct" or "indirect," and it may flow from the defendant's conduct of the enterprise's affairs or from his simple participation in that conduct. As a result, there are various ways in which the "conduct or participate" requirement can be satisfied. Because the requirement may be met "in a variety of ways, * * * it [is] difficult to formulate in the abstract any general test," *H.J. Inc.*, 492 U.S. at 241, as the formulations developed by the courts of appeals suggest.[17]

[16] The showing of employment by or association with the enterprise is a separate element of Section 1962(c). It can be satisfied in a number of ways, including through evidence of the defendant's position or role in the enterprise, see *United States* v. *Horak*, 833 F.2d at 1239; *United States* v. *Swiderski*, 593 F.2d 1246, 1249 (D.C. Cir. 1978), cert. denied, 441 U.S. 933 (1979); or evidence of his transactions with the enterprise, see *United States* v. *Bright*, 630 F.2d 804, 830 (5th Cir. 1980); *United States* v. *Yonan*, 800 F.2d 164, 167-168 (7th Cir. 1986), cert. denied, 479 U.S. 1055 (1987).

[17] The two leading formulations are represented by *United States* v. *Scotto*, *supra*, and *United States* v. *Cauble*, *supra*. See note 7, *supra*. Although cases applying these formulations have generally reached correct results, neither line of cases affords a precise guide

Devising a comprehensive formula to apply the "conduct or participate" element is difficult because of the diversity of ways in which defendants can interact with different types of enterprises. RICO applies to both legitimate and illegitimate enterprises;[18] to victim as well as aggressor enterprises;[19] and to insiders as well as outsiders.[20] The statute, however, draws no distinction between these categories. The specific activity of the defendant, therefore, will necessarily influence what factors are relevant in the analysis.

2. *Application of the "conduct or participate" requirement in particular cases.* As the following cases show, the "conduct or participate" requirement is generally satisfied whenever the defendant (a) engages in racketeering activity through the enterprise that furthers the enterprise's objectives; (b) uses the enterprise's resources or his association with the enterprise to facilitate his crimes; or (c) targets criminal activity so as to corrupt the enterprise's actions. Although these are not the

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for application of the "conduct or participate" element in all settings. *Scotto*'s suggestion that it is sufficient if the racketeering activity is "related to" the enterprise's activities (641 F.2d at 54) provides little concrete guidance and may suggest overbroad application of RICO, although it has not done so in decided cases. *Cauble*, on the other hand, makes it an element that the racketeering activity be "facilitated" by the defendant's "position in the enterprise" (706 F.2d at 1333). That approach may be too narrow in some situations, as it is not readily applicable to outsiders or to defendants who victimize the enterprise.

[18] *United States* v. *Turkette*, 452 U.S. 576 (1981).

[19] "The government need not prove that the racketeering activity 'benefitted' or 'advanced the affairs of' the enterprise * * * [n]or must the government demonstrate that the enterprise itself was corrupt or that it authorized the defendant's conduct." *United States* v. *Cauble*, 706 F.2d at 1333 n.24.

[20] See *United States* v. *Garver*, 809 F.2d 1291, 1301 (7th Cir. 1987); *Schacht* v. *Brown*, 711 F.2d 1343, 1360 (7th Cir.), cert. denied, 464 U.S. 1002 (1983); *United States* v. *Forsythe*, 560 F.2d 1127, 1135-1136 (3d Cir. 1977).

only situations in which the "conduct or participate" requirement can be satisfied, they represent characteristic applications of RICO that are at the core of the statute's coverage.

a. When the defendant's racketeering activity directly furthers the objectives of the enterprise, the "conduct or participate" element is satisfied. This approach readily applies to RICO prosecutions of persons involved with wholly criminal organizations. See *United States* v. *Watchmaker*, 761 F.2d 1459, 1475-1476 (11th Cir. 1985) (defendants participated in the conduct of motorcycle gang's affairs by engaging in acts of drug dealing and extortion with and at the behest of gang members), cert. denied, 474 U.S. 1100 (1986); *United States* v. *Ellison*, 793 F.2d 942, 950 (8th Cir.) (leader of white supremacy group directed arson activities involving that enterprise, which boosted members' morale and commitment), cert. denied, 479 U.S. 937 (1986).[21] It also applies to persons who further the illegal acts of businesses that exist for generally legitimate purposes. See *United States* v. *Horak*, 833 F.2d at 1239 (employee of subsidiary participated in the conduct of parent company by fraudulently procuring contracts for the subsidiary, which financially benefited the parent); *United States* v. *Zauber*, 857 F.2d 137, 150 (3d Cir. 1988) (pension fund officials furthered the affairs of a mortgage company by providing capital to that company for its loans in return for kickbacks solicited from company representatives), cert. denied, 489 U.S. 1066 (1989).

b. The defendant's use of the enterprise's resources or his association with the enterprise can also establish that

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[21] RICO indictments of traditional organized crime families may also be brought on that approach. See *United States* v. *Angiulo*, 897 F.2d 1169, 1170-1177 (1st Cir.) (defendants carried out business of organized crime family through gambling, murder, and loansharking), cert. denied, 111 S. Ct. 130 (1990); *United States* v. *Indelicato*, 865 F.2d 1320, 1371 (2d Cir. 1988) (en banc) (defendants conducted the affairs of the "Commission" of La Cosa Nostra crime families through a pattern of murders), cert. denied, 493 U.S. 811 (1989).

he has conducted or participated in the conduct of the enterprise's affairs. Typically, this form of "conducting" or participating in the conduct of an enterprise's affairs involves the defendant's use of his position in the enterprise to attain illegal ends. See *United States* v. *Tillem*, 906 F.2d 814, 822 (2d Cir. 1990) (defendant was "enabled to commit extortion by reason of his position as an inspector and supervisor at the City Health Department"); *United States* v. *Robilotto*, 828 F.2d 940, 948 (2d Cir. 1987) (union official used influence over union (the enterprise) to place union welfare funds, in return for which he obtained personal loans), cert. denied, 484 U.S. 1011 (1988); *United States* v. *Qaoud*, 777 F.2d 1105, 1115-1117 (6th Cir. 1985) (public officials accepted bribes and obstructed justice in court system), cert. denied, 475 U.S. 1098 (1986); *United States* v. *Cauble*, 706 F.2d at 1341 (defendant used the private jet and funds of the enterprise, a partnership with his wife and son, to facilitate his smuggling activities); *United States* v. *LeRoy*, 687 F.2d 610, 617 (2d Cir. 1982) (defendant's position in union enabled him to obtain illegal payments and embezzle funds), cert. denied, 459 U.S. 1174 (1983); *United States* v. *Scotto*, 641 F.2d at 51 (union officials received payoffs from employers for reducing fraudulent compensation claims and assisting the employers in getting business). There is no requirement that such a defendant have a particularly high level of responsibility. *United States* v. *Kovic*, 684 F.2d 512, 516-517 (7th Cir.) (defendant used his position in police department to obtain kickbacks from vendors), cert. denied, 459 U.S. 972 (1982). Even outsiders who pay an entity to perform illegal acts can be held liable under RICO. *United States* v. *Manzella*, 782 F.2d 533, 538 (5th Cir.) (RICO conspiracy involving customers of arson enterprise), cert. denied, 476 U.S. 1123 (1986).

c. Racketeering activity that is targeted at the enterprise with the purpose or effect of corrupting its actions can establish the requisite conduct or participation. The classic example is the making of payments to representatives of an organization to obtain improper action by the organization. *United States* v. *Yonan*, 800 F.2d at 167 (defense attorney who attempted to bribe prosecutor to influence the disposition of cases participated in the conduct of affairs of state's attorney's office); *United States* v. *Roth*, 860 F.2d 1382, 1390 (7th Cir. 1988) (lawyer who bribed judges participated in the conduct of the court's affairs), cert. denied, 490 U.S. 1080 (1989); *United States* v. *Bright*, 630 F.2d 804 (5th Cir. 1980) (bondsman who bribed sheriff participated in the conduct of the sheriff's office).

d. Those examples do not exhaust the ways in which the "conduct or participate" element may be satisfied; the ultimate inquiry is whether the defendant has carried out the affairs of the enterprise through a pattern of predicate crimes. Of relevance here, there is no exemption in the statute for purportedly "independent" professionals or advisers who carry out a pattern of predicate crimes in the course of advising or representing other entities.[22]

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[22] The critical issue under RICO is the *relationship* between the defendant's crimes and the affairs of the enterprise, as "[c]onducting an enterprise that affects interstate commerce is obviously not in itself a violation of § 1962, nor is mere commission of the predicate offenses." *Sedima*, 473 U.S. at 496. In this case, however, the district court did not squarely address that relationship. It stated only that respondent had "reviewed a series of completed transactions, and certified the Co-op's records as fairly portraying its financial status," and went on to find that "such activities fail to satisfy the degree of management required." Pet. App. A60. The gravamen of the RICO claim, however, was not that respondent reviewed and certified financial reports, but that it engaged in a pattern of mail, wire, and securities fraud in creating, and then explaining false and misleading financial statements on the Co-op's behalf. See *Plaintiffs' Responding Memorandum to the Motion of the Arthur Young Defendants for Summary Judgment*, Nos. 85-2044, 2096, 2155, & 2259 (W.D. Ark. filed Sept. 5, 1986), at 56-66. The jury later accepted that claim in finding respondent accountable for having "originated" the false or misleading statements "by which means the demand notes were sold." 18 Tr. 80 (Nov. 15, 1986) (jury

An outside adviser will often maintain an arm's-length professional relationship with a client, and the two will carry out their respective functions with a degree of independence. See *United States* v. *Arthur Young & Co.*, 465 U.S. 805, 817-818 (1984) ("'public watchdog' function [of accountants] demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust"). That relationship, standing alone, does not implicate RICO. If, however, an adviser compromises its independence by becoming instrumental in perpetrating illegal acts on behalf of the client, with the requisite degree of criminal intent, it may fairly be characterized as a participant in the conduct of the organization's affairs.[23] If the adviser's actions amount to a pattern of fraudulent conduct, the RICO statute may be applicable to that person.[24]

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instructions with respect to claims under the federal securities laws, 15 U.S.C. 78j(b), and 17 C.F.R. 240.10b-5).

[23] Here, for example, petitioners contend that respondent prepared and explained fraudulent financial statements that allowed the Co-op to continue in existence for years after it had actually become insolvent. See also *Baggio* v. *EC Solar, Inc.*, No. 88 C-1893, 1990 U.S. Dist. LEXIS 5,569 (N.D. Ill. May 8, 1990) (accountants who prepare fraudulent tax returns for clients satisfy the "conduct or participate" element); *Bank of America* v. *Touche Ross & Co.*, 782 F.2d at 970 (accountants were alleged to have assisted in the preparation and dissemination of false financial statements); *In re Federal Bank & Trust Co. Securities Litigation*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,565, at 98,879-98,880 (D. Ore. 1984) (accountants' role in confirming transactions in an investment program was featured in marketing literature to investors; accountants could be liable for fraudulently failing to perform that role). Likewise, lawyers who represent clients in business transactions by drafting fraudulent documents can be said to have "participate[d] in the conduct" of their client's affairs. See *Blake* v. *Dierdorff*, 856 F.2d 1365, 1372 (9th Cir. 1988) (attorneys were involved in allegedly fraudulent disclosures on a continuing basis and had a stake in client's success); *Odesser* v. *Continental Bank*, 676 F. Supp. 1305, 1312 (E.D. Pa. 1987).

[24] Isolated or sporadic misconduct in the course of a client engagement would not be likely to trigger RICO's application. Cf. *Blake* v. *Dierdorff*, 856 F.2d at 1371 (accountant's conduct of a single audit held not to constitute a pattern). RICO requires that the defendant commit predicate crimes forming a "pattern." *H.J. Inc.*, 492 U.S. at 239 (pattern requires a showing that "the racketeering predicates are related, *and* that they amount to or pose a threat of continued criminal activity"). In addition, in order to recover damages in a private civil action under RICO, the plaintiff must establish proximate cause, which requires a showing that the plaintiff was directly injured by the alleged misconduct. *Holmes* v. *Securities Investor Protection Corp.*, *supra*.

C. The District Court's Entry Of Summary Judgment Rested On An Incorrect Legal Standard

Under the principles set forth above, the grant of summary judgment in favor of respondent should be vacated. Petitioners claim that respondent acted as the Co-op's auditor and intentionally created and disseminated false and misleading financial information for the Co-op, with the result that members purchased largely valueless Co-op securities. The district court held that respondent's auditing activities "fail to satisfy the degree of management [or operation] required by *Bennett* v. *Berg*," and dismissed the RICO claim. Pet. App. A60. The court of appeals affirmed for the same reason, stating that respondent's accounting actions, even though improper, "in no way rise to the level of participation in the management or operation of the Co-op." *Id.* at A46.

In our view, the courts below applied the wrong legal standard. Although not all action by an outside adviser to an enterprise constitutes the "conduct or participat[ion] * * * in the conduct of such enterprise's affairs," 18 U.S.C. 1962(c), it is not necessary for liability under RICO that the advisers participate (in some unexplained way) in the "management" or "operation" of the client. If an accounting firm effectively assumes the enterprise's responsibility for characterizing its transactions and creating its financial statements—and does so through a pattern of fraudulent and misleading statements that constitute "racketeering activity"—it can be held liable for

"conduct[ing] or participat[ing], directly or indirectly, in the conduct of [the] enterprise's affairs."

The courts below have not had the opportunity to apply the correct legal standard to the "conduct or participate" issue in this case. Those courts, however, have gained great familiarity with the complex facts of this case in the course of prior proceedings. In light of that circumstance, and the significant development of the record since the motion for summary judgment was granted,[25] this case should be remanded to the court of appeals for further proceedings on the RICO claim.

CONCLUSION

The judgment of the court of appeals should be vacated, and the case should be remanded for further proceedings.

Respectfully submitted.

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[25] After the RICO claim was dismissed, the case went to trial and the jury concluded that respondent had committed securities fraud, which is one of the predicate acts alleged in the RICO claim, by "originating" the false or misleading statements in the Co-op's financial reports. See note 22, *supra*.

APPENDIX

18 U.S.C. 1962 provides:

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participation in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern o[f] racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control over of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

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